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MEMORANDUM OF ARGUMENT OF GEORGE STUART PATTERSON.

I. Petition for Modification of Order and Scope of Proceeding.

The Carriers, parties to this proceeding, have filed a petition asking the Commission for a modification of the order made in the so-called "Five Per Cent. Case," so as to permit the Carriers to make effective the rates specified in the tariffs, which were by said order directed to be cancelled, except so far as said rates may have been or may be superseded by advances filed in accordance with the report of the Commission.

The authority of the Commission to grant this relief is contained in Sections 16 and 16-a of the Interstate Commerce Act. Section 16 provides—"The Commission shall be authorized to suspend or modify its orders upon such notice and in such manner as it shall deem proper."

Section 16-a provides—"In case a rehearing is granted the proceedings thereupon shall conform as nearly as may be to the proceedings in an original hearing, except as the Commission may otherwise direct; and if, in its judgment, after such rehearing and the consideration of all facts, including those arising since the former hearing, it shall appear that the original decision, order, or requirement is in any respect unjust or unwarranted, the Commission may reverse, change, or modify the same accordingly."

The duty, therefore, is imposed upon the Commission of considering not merely the facts arising since the former hearing, but, in the language of the Statute, "all facts, including those arising since the former hearing."

At the time (July 29, 1914) the Commission rendered its opinion in this case, the Commission had before it the financial statements of the Carriers from the fiscal year 1898 up to and including May 30, 1914.

Since that date two fundamental considerations have developed:

1. The figures for the entire fiscal year 1914, now available, showing as they do an extraordinary reduction in the return earned on the investment, disclose the existence of a condition much worse than had been expected; and

2. The War in Europe has confronted the Carriers with a problem wholly without precedent.

These facts when taken into consideration with the other facts appearing upon this record, justify the belief of the Carriers that the order should be modified so as to permit the tariffs in question to become effective as requested.

II. Financial Status of the Carriers as disclosed by the old record.

It will be remembered that the statements filed by the Carriers for the 35 Systems showed that between 1903 and 1913 the property investment account had increased $1,980,000,000, and during that same period net operating income had increased $85,316,000, or

an amount equal to 4.31 per cent. on the increased property investment, while between 1910 and 1913, the property investment had increased $659,862,000, and and the net operating income had showed an actual decrease of $16,311,000. During this same period, the per cent. of surplus (after payment of interest and dividends) to total capital obligations, decreased from 1.83 per cent. in 1903 to 1.54 per cent. in 1910, and to 1.19 per cent. in 1913.

So, also, taking into consideration the combined figures of the three principal Systems, the Baltimore & Ohio, the New York Central and the Pennsylvania, which the Commission had treated (p. 420 of the opinion) as properly typical of the situation, it appeared that between 1903 and 1913 the property investment had increased $1,100,000,000, and net operating income had increased $39,745,000, an amount equal to 3.59 per cent. on the increased property investment, while between 1910 and 1913 their property investment had increased 423 millions, with a decrease in net operating income of $8,380,000, and the surplus, or margin of safety, which in 1903 had been 2.18 per cent., and 2.03 per cent. in 1910, had fallen to 1.51 per cent. in 1913. It was these facts, together with the result of the eleven months of 1914, which led the Commission to state on page 384 of their report:

> "In view of a tendency towards a diminishing net operating income as shown by the facts described we are of opinion that the net operating income of the railroads in official classification territory, taken as a whole, is smaller than is de-

manded in the interest of both the general public and the railroads; and it is our duty and our purpose to aid, so far as we legally may, in the solution of the problem as to the course that the carriers may pursue to meet the situation."

III. The Financial Operations of the Carriers for the twelve months ending June 30, 1914, as well as for the months of July and August of the present calendar year.

The Commission said in its report (p. 423) after considering the returns for the first eleven months of the fiscal year ending June 30, 1914: "When the returns for the full year are at hand it is not improbable that the ratio of net operating income to property investment will be found to have been as low as 4.35 per cent., or 1.01 per cent. less than for the preceding year." The Commission did not, of course, at that time have before it the figures showing the increase in property investment which had been made during that year, and now that those figures are available, it appears that the return on property investment for that period has fallen to 3.99 per cent., the lowest figure in the last fifteen years.

The complete returns for 1914 show for the 35 systems—in round figures,—

An increase in total capital obligations of 159 millions of dollars,—

An increase in Property Investment of 249 millions,—

A *decrease* in operating revenues of 48 millions,—

An increase in operating expenses of 22 millions,—

A *decrease* in net operating revenue of 70½ millions,—

An increase in taxes of 3 millions,—

A *decrease* in net operating income of 76 millions,—

A *decrease* in net corporate income of 96 millions,—

A *decrease* in dividends paid of 12 millions,—and

A *decrease* in *surplus over dividends* of 84 millions, the surplus of nearly 76 millions in 1913 having disappeared and a deficit of 8 millions being shown in 1914.

A comparison of the details of the 1914 figures, not only with the corresponding figures for 1913, but also with the figures for the preceding fourteen years, seems to indicate something fundamentally wrong with the railroad industry.

The figures for the fiscal year 1914 disclose their true significance better when compared on a proper basis with similar years in the past than they do when compared solely with 1913. Looking over the fifteen years 1900 to 1914 inclusive, it is easy to discern several years of comparative prosperity—and by prosperity is meant large operating revenues—and several years of comparative depression when operating revenues actually declined or remained stationary. For example, the years 1903, 1907, 1910 and 1913, were years of comparative prosperity, and the years 1904, 1908, 1911 and 1914 were years of comparative depression. For convenience, we may term the years of prosperity "peak years" and the years of depression "valley years." In order to avoid multiplying comparisons, the years 1903 and 1904 will be taken as a starting point.

The first series of comparisons that naturally suggest themselves is comparison of "peak" years with "peak" years, and we start the series with 1903. We then have figures for the four years, 1903, 1907, 1910 and 1913. It is not necessary to consider anything more than the items of operating revenue, operating expenses, net operating revenue and net operating income, for these items will give us sufficient information as to the conditions in the transportation industry as a whole, or at least of the conditions of the industry as disclosed in the operations of the thirty-five systems.

If we take the first comparison, 1903 with 1907, we find an increase in operating revenue from $871,000,000 to $1,141,000,000 in round figures, or 31%; an increase in operating expenses from $585,000,000 to $781,000,000 or 33%; an increase in net operating revenue from $286,000,000 to $360,000,000, or 26%; and an increase in net operating income from $251,000,000 to $318,000,000 or about 26%. There is nothing in this comparison to indicate anything unfavorable in the industry from the carriers' point of view.

Taking the second comparison, namely, 1907 with 1910— I will not repeat the figures in dollars, but merely the percentages—an increase in operating revenues is shown of 8.5%; an increase in operating expenses of 6.6%; an increase in net operating revenue of 12.5%, and an increase in net operating income of 11%. Here again the conditions so far as disclosed by these figures are not unsatisfactory.

When we come, however, to the third "peak" comparison namely, 1910 with 1913, a marked change in

conditions is apparent. Operating revenue increased 15%; operating expenses 22%; net operating revenue decreased seven-tenths of one per cent., and net operating income decreased 4.6%. These results are unsatisfactory in a high degree. Nothing but the fact that 1913 was a year in which the carriers' business and operating revenues were the highest in their history could for a moment disguise the great change for the worse that had taken place in the industry, which change chiefly showed itself in the increased cost of operation.

To recapitulate: Up to 1910 so far as "peak" comparisons show, the industry was in at least a not unsatisfactory condition from the carriers' point of view. Since that time it has become decidedly unsatisfactory.

Now taking what we may call the "valley" comparisons we find a substantially similar showing. Between 1904 and 1908 operating revenue increased 22%; operating expenses increased 25%; net operating revenue increased 13.3%, and net operating income 13%, a showing on the whole not extremely unsatisfactory.

The second "valley" comparison, 1908 with 1911, shows operating revenue increased 14.6%; operating expenses increased 14.2%; net operating revenue increased 15.6% and net operating income increased 12.4%—nothing very unsatisfactory here. When we come, however, to the comparison 1911 with 1914, we find a great change, precisely similar to that which we found in the "peak" comparison, 1910 with 1913. Operating revenue increased 9.6%; operating expenses increased 17.6%; net operating revenues decreased

almost 10% and net operating income decreased over 16%. This is a very plain story, indicating something decidedly wrong with conditions.

One other series of comparisons is necessary in order to bring out the full significance of the 1914 returns, and that is a comparison of what I may call the "slump" periods, and by that I mean the period covered between a peak year and the bottom of the depression immediately following. It so happens that in the period which we are considering, the valley year was in all cases the year following the peak year—that is to say, the valley year 1908 immediately succeeded the peak year 1907; the valley year 1911 immediately succeeded the peak year 1910, and the valley year 1914 immediately succeeded the peak year 1913. The year 1911 was in one sense of the word not a true valley year, in that there was a very slight increase in operating revenues as compared with 1910, but it was a true valley year in the matter of net results, and for the purpose of this comparison may fairly be considered as constituting a "slump" period.

In 1908 operating revenues decreased 4%; operating expenses decreased one-half of one per cent., and net operating revenue decreased 11.7%, and net operating income decreased 13%. Thus, with a decrease of 4% in operating revenue, net operating income decreased 13%.

In 1911 as compared with 1910, operating revenues increased 1.4%; operating expenses increased 6.6%; net operating revenues decreased 9.2%, and net operating income decreased 12%. It will be noted that in this slump period results were materially worse from

the carriers' point of view because without any decrease at all in operating revenues the loss in net operating income was almost as great as it was in 1908 when operating revenues decreased 4%.

Now when we come to consider 1914 as a slump period following the peak of 1913, we find a decrease in operating revenues of only 3.4%; an increase in operating expenses of 2.2%; a decrease in net operating revenues of 17.5% and a decrease in net operating income of over 22.5%. Comparing this period with the 1908 period, we find that with a smaller ratio of falling off in operating revenues, the falling off in net operating income was proportionately very much larger. In other words, the 1914 slump period was much the worst of the three.

We thus have cumulative evidence from all these comparisons pointing to the most recent period in the history of these carriers as the worst of any. The nearer we come to the present day the more unfavorable do we find the conditions. Furthermore, if we consider these results with reference to the mileage of track operated, the unfavorable character of the exhibit becomes even more marked. The year 1914 showed the largest operating revenues per mile of first main track operated of any year in the fifteen that the Commission took for its review, with the sole exception of 1913. The operating revenue per mile of main track in 1914 was $23,466, whereas in 1903, the starting point for my present comparisons, it was but $16,243. Yet, when we consider net operating income per mile of first main track we find that in 1914 this was $4,441., as against $4,690., in 1903.

In other words the entire growth of these systems in business and operating revenues between 1903 and 1914 amounting as it did to $7,223. per mile of first main track has vanished in increased operating expenses and increased taxes, and $249. per mile additional has gone in the same way.

It must be remembered in considering these figures that all through the entire period under consideration there has been a continuous investment of money in these properties. The property investment in 1903 was in round figures $4,300,000,000. In 1914 this property investment was $6,500,000,000. The result to the carriers is that in a year when their business was within 3.4% of the highest ever recorded, the return shown on their property investment has fallen not only below the ratio of any one of the past fifteen years chosen by the Commission for its review, but as Mr. Rea pointed out, lower even than in the two years, 1898 and 1899, which were expressly excluded by the Commission from its comparisons because they were not representative years being years of great depression.

IV. Financial Operations of the Baltimore & Ohio, New York Central and Pennsylvania Systems for the twelve months ended June 30, 1914.

In order to save time, I shall not treat the figures of the three so-called typical systems, the Baltimore & Ohio, New York Central and the Pennsylvania, in detail similar to that of the 35 Systems. The results of such comparison would be substantially the same and lead to the same conclusions. These three strong

Systems disclose a condition of inherent weakness, just as does the general group of railroads in Official Classification Territory. Comparing, the complete returns for 1914 with those for 1913, the three Systems show an increase in capital obligations of $112,800,000, an increase in property investment of $135,200,000, a decrease in operating revenue of $31,-200,000, an increase in operating expense of $4,800,-000, (notwithstanding the smaller amount of business handled), and a decrease in net operating income of $41,476,000. This was the smallest net operating income shown in ten years. The net corporate income decreased $46,690,000, and was the smallest since 1900. These three companies had a surplus in 1914 (after payment of dividends) of only $461,000, or .014 of 1 per cent. on total capital obligations of $3,200,000,000, and that after an average rate of dividend paid of 5.53 per cent., the lowest average rate since 1906.

V. Returns for July and August.

With regard to the returns for July and August, I can only say that they show an aggravation of the carriers' difficulties in that the tendency towards progressive diminution of operating revenues is evident. The decrease in operating revenues in July was 6.7% and that in August 5.9%. The carriers have been compelled to institute economies in operations of a kind that are known as forced economies. As Mr. Willard and Mr. Rea pointed out, savings of this kind are not true savings nor can they be continued for very long. The railroads have been driven to them by stress of necessity, but in so doing they are in effect borrowing

from the future and sooner or later debts now contracted in this way must be paid.

It is most unfortunate that the carriers should, while in such a condition of inherent weakness, be compelled to encounter a storm so serious as that which the war has brought upon the world. Even had their condition been fully recognizable when the Commission made its report last July; even had the Commission recognized that condition and granted them all the relief they prayed for, they would still have had before them a hard struggle in the future.

VI. Suggestions of the Commission.

After finding in its opinion the inadequacy of the net operating revenues of the Carriers, and specifically authorizing certain increases in Central Freight Association Territory, the Commission made certain suggestions which it expressly designated as tentative and subject to further consideration by the Commission as to the means which the Carriers might pursue to secure additional net revenue.

As appears from the record, the Carriers have been diligently at work investigating these suggested sources of revenue, the extent to which they are available, and the time in which they may be secured. Such investigation has embraced subjects such as the storage of freight; charges for the reconsignment and diversion of carload freight; expense of bracing shipments of lumber or other articles; the privilege of completion of loading of livestock; trap or ferry-car service; allowance for weight of dunnage; charges for

refrigeration; charges for the return of containers, and for furnishing dunnage; milling in transit, elevation allowances, and many other subjects.

It should be pointed out that many of these practices, such as storage, reconsignment, trap or ferry-car service have been in existence for many years, and their curtailment, or the imposition of additional charges will meet the bitter opposition of shippers generally, and will doubtless as heretofore indicated by the Commission be made the subject of separate inquiry by the Commission.

In this connection, it will be remembered that following the decision of the Commission in the Industrial Railways Case, the Carriers published tariffs cancelling the allowances to industrial or short lines of railroad. The most important of these cancellations have been set aside by the Public Service Commissions of New York, Pennsylvania, Ohio and other States, and the revenue which was expected to accrue to the Carriers from the decision in question has not materialized.

Following the lines as laid down by the Interstate Commerce Commission in that same case, the Carriers have imposed charges for spotting cars at plants having what is known as a plant system of railways. These tariffs have been suspended by the Public Service Commissions of New York, and certain other States, as well as by the Interstate Commerce Commission. So, also, the Western Trunk Lines have filed tariffs imposing additional charges for the trap or ferry-car service at Chicago, which charges have

been suspended by the Interstate Commerce Commission, as well as by the Public Utility Commission of Illinois.

A bare recital of these facts is sufficient to indicate that no substantial relief to the Carriers can be expected in the near future from changes in practices on the lines above indicated.

The question of an increase in passenger fares has also received the earnest attention of the Carriers, and an increase has been made from 2 to 2¼ cents per mile in the charge for mileage books in Trunk Line Territory, and the Interstate Commerce Commission as well as the New Jersey Commission, though complaint has been made, have declined to suspend these tariffs. Other passenger readjustments are under consideration, but it should be pointed out that there are Two-cent fare laws in effect in New York on a portion of the New York Central System, and in the States of Ohio, Indiana, Illinois, West Virginia and Michigan. It may also be noted in this connection that nothing has been done by Congress to remedy the conceded inadequacy of railway mail pay revenues, and there does not seem any possibility of securing any increased compensation to the railroad companies for the transportation of express matter.

The Carriers propose to increase the rates on certain commodities which were particularly referred to by the Commission. The proposed increases, as it appears from the testimony, are in many of these cases more than five per cent., and they doubtless will also be made the subject of separate investigation and determination by the Commission.

It therefore appears that there is no possibility of securing from these sources, in the near future, the relief which is so urgently demanded by the Carriers.

VII. Conclusion.

It is therefore submitted that a consideration of all facts including those arising since the former hearing show conclusively that the needs of the Carriers can only be met practically by the remedy of a general advance in freight rates, such as that suggested by the Carriers.

That under these circumstances the Commission has the power to grant that general advance can not be questioned, but that matter will be more specifically dealt with by Counsel who will follow. It may be said, however, that the mere physical inability of the Commission to consider each particular rate involved in a general advance in freight rates does not constitute a reason for not permitting that advance.

This proposition is conclusively established by the decisions of the Commission in the Express Cases 24 I. C. C. 381, the Arlington Heights Case, 19 I. C. C. 148 and the Inter-Mountain Case—the decisions of the Commission in the last two cases having been affirmed by the Supreme Court of the United States.

It is also quite clear that the needs of the Carriers for additional revenue sustain the burden of proof in the case of a general advance in freight rates. That appears to be conceded in the opinions of Commissioners Prouty and Lane in the 1910 cases, and by the ex-

press decision of the Commission in Railroad Commission of Texas vs. A. T. & S. F. Ry. Co., 20 I. C. C. 464, where the Commission sustained an advance in class rates from St. Louis to Texas common points, as well as an advance in many of the commodity rates, upon the ground of the general financial condition of the Carriers and expressly declined (p. 468) to investigate the reasonableness of individual rates.

Neither can it be successfully asserted that in order to justify a general advance in all rates, it is essential to establish that the cost of transporting each particular class of traffic has increased proportionately. This must be so for two obvious reasons.

In the first place, it is practically impossible to segregate each class of traffic and determine its cost of transportation. The inability to do this necessarily prevents any determination of the fact as to whether the cost of each class of traffic has increased proportionately. Secondly, the Commission has repeatedly held (West Va. Coal Case, 22 I. C. C., p. 623; Connellsville Coke Case, 27 I. C. C., p. 132; Youngstown Coal Case, 29 I. C. C., p. 436) that the cost of service though a possible factor in the determination of a reasonable rate, is not a conclusive factor, and, therefore, even if it were possible to determine whether the cost of transportation of each class of traffic had increased in the same proportion, the mere fact that it had not so increased would not be conclusive as against the reasonableness of a general advance in all freight rates.

These matters however will be dealt with in greater detail by other counsel.

Mr. Commissioner Lane said in the Western Advance Rate Case, 20 I. C. C. 307;

> "We do not say that the carriers may not increase their income. We trust they may and confidently believe they will. If the time does come when through changed conditions it may be shown that their fears are realized, or approaching realization, and from a survey of the whole field of operations there is evidence of a movement which makes against the security and lasting value of legitimate investment and an adequate return upon the value of these properties, this Commission will not hesitate to give its sanction to increases which will be reasonable."